STATE OF CONNECTICUT
OFFICE OF POLICY AND MANAGEMENT

TESTIMONY PRESENTED TO THE

FINANCE, REVENUE AND BONDING COMMITTEE

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Secretary

Office of Policy and Management

In Opposition To Raised Bill No. 5479

An Act Concerning the Amortization Schedule for Bonds Issued by Municipalities

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Good morning, Senator Daily, Representative Staples and distinguished members of the Finance, Revenue and Bonding Committee. Thank you for the opportunity to submit testimony concerning Raised Bill No. 5479 -- An Act Concerning the Amortization Schedule for Bonds Issued by Municipalities. It is our strong belief that this bill would amend state statutes governing municipal borrowing in a manner that would enable fundamentally unsound fiscal practices.

This bill would effectively remove the annual principal retirement requirement for general obligation bonds that Connecticut municipalities issue pursuant to Chapter 109 of the Connecticut General Statutes. It would do so by eliminating the requirement under Section §7-371 that such bonds have annual or semi-annual principal payments that substantially equalize annual principal and interest payments -- a mortgage-type amortization -- or that backload annual principal amounts by no more than 50% of any prior principal payment. (Term bonds are subject to sinking fund payments that would meet these same requirements.)

Under this bill, municipalities that issue bonds would be able to make minimal annual principal payments until the final maturity date, which could be 20 or more years after the issuance of the bonds. At that time, there would be a "bullet final maturity," which could essentially be for the full amount of the bond issue.

Existing state statutes governing municipal borrowing and debt give towns the ability to fund their capital needs in a cost-effective, yet prudent manner. Allowing a municipality to delay making principal payments until the maturity date of the bonds would open the door to short-term budget fixes that would result in higher long term costs. We have various concerns with allowing such a situation to occur.

- Higher Costs: In general, the longer it takes to make principal payments on a bond means there are higher interest payments, ultimately resulting in total higher debt service costs.

- Intergenerational Equity Concerns: In order to finance high cost capital related items such as school building renovation projects, a municipality generally issues bonds to finance the project. If the financed project has a 20-year useful life, it is considered appropriate to spread the cost of the project over its life by issuing bonds with annual principal payments so that current and future taxpayers that benefit from the capital item contribute to the repayment. Allowing a municipality not to pay any of the principal on this debt until maturity would raise the issue of intergenerational inequity.

- Fiscal Impact Concerns: Permitting municipalities to issue bonds having a bullet final maturity requiring repayment of the full principal amount in a single budget year, could lead to significant financial distress in that year. The municipality could not spread that cost over several budget years, as Connecticut statutes do not permit the issuance of refunding bonds that extend the final maturity of prior bonds.

- Rating Agency Concerns: One tool Moody's rating agency uses to gauge a municipality's willingness and ability to repay debt is the structure of principal amortization. Moody's indicates that the structure of the principal amortization should match the useful life of the financed project. Furthermore, Moody's states that "...repaying a liability for an asset that no longer exists could challenge the willingness of an entity to make debt payments." Moody's considers 10 years to be the average time taken to retire 50% of a debt through the amortization of principal and that "...balloon payments, or large final payments, could pose uncertainty and liquidity risks." From these statements, it appears that Moody's would have concerns with municipalities issuing bond that (1) allows the municipality to structure the debt so that principal payments could occur after the life of an asset financed by the debt proceeds: and (2) delays amortizing the principal payment of the bond, necessitating a large balloon payment close to the end of the bond maturity and many years from when the bond was originally issued.

In summary, we believe that this bill represents a fundamental shift towards an unsound financial practice for municipalities that would enable short-term fixes at the expense of long-term costs. As a result, the Office of Policy and Management requests that the members of the Finance, Revenue and Bonding Committee issue an unfavorable report concerning Raised Bill No. 5479.